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In the Supreme Court of the United States

OCTOBER TERM, 1979

ELMER B. STAATS, COMPTROLLER GENERAL OF THE UNITED STATES, AND UNITED STATES OF AMERICA,
PETITIONERS

v.

BRISTOL LABORATORIES DIVISION OF BRISTOL-MYERS COMPANY

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

WADE H. MCCREE, JR.
Solicitor General

ALICE DANIEL
Assistant Attorney General

MARK I. LEVY
Assistant to the Solicitor General

MICHAEL KIMMEL
ROBERT KAPLAN
Attorneys

Department of Justice
Washington, D.C. 20530
(202) 633-2217

QUESTION PRESENTED

Whether, with respect to negotiated government contracts, the Comptroller General is authorized by law to examine the contractor's books and records pertaining to costs of research and development, advertising and promotion, distribution, and administration, where such costs, although not allocated by the contractor to particular products or calculated on a product basis in determining price, are defrayed by the contractor from commingled general revenues that include the government's payments under the contract.

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PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

The Solicitor General, on behalf of the Comptroller General of the United States and the United States of America, petitions for a writ of certiorari to review the judgment of the United States Court of Appeals for the Second Circuit in this case.

OPINIONS BELOW

The opinion of the court of appeals (App. A, *infra*, 1a–4a) is reported at 620 F.2d 17. The opinion of the district court (App. B, *infra*, 5a–12a) is reported at 428 F. Supp. 1388.

JURISDICTION

The judgment of the court of appeals was entered on March 25, 1980 (App. C, *infra*, 13a–14a). On June 12, 1980, Mr. Justice Marshall extended the time for filing a petition for a writ of certiorari to and including August 22, 1980. The jurisdiction of this Court is invoked under 28 U.S.C. 1254 (1).

STATUTORY PROVISIONS INVOLVED

1. 10 U.S.C. 2313(b) provides:

> Except as provided in subsection (c), each contract negotiated under this chapter shall provide that the Comptroller General and his representatives are entitled, until the expiration of three years after final payment, to examine any books, documents, papers, or records of the contractor, or any of his subcontractors, that directly pertain to, and involve transactions relating to, the contract or subcontract.

2. 41 U.S.C. 254(c) provides:

> All contracts negotiated without advertising pursuant to authority contained in this Act shall include a clause to the effect that the Comptroller General of the United States or any of his duly authorized representatives shall until the expiration of three years after final payment have access to and the right to examine any directly pertinent books, documents, papers, and records of the con-

tractor or any of his subcontractors engaged in the performance of and involving transactions related to such contracts or subcontracts. Under regulations to be prescribed by the Administrator, however, such clause may be omitted from contracts with foreign contractors or foreign subcontractors if the agency head determines, with the concurrence of the Comptroller General of the United States or his designee, that the omission will serve the best interests of the United States. However, the concurrence of the Comptroller General of the United States or his designee is not required for the omission of such clause—

(1) where the contractor or subcontractor is a foreign government or agency thereof or is precluded by the laws of the country involved from making its books, documents, papers, or records available for examination; and

(2) where the agency head determines, after taking into account the price and availability of the property or services from United States sources, that the public interest would be best served by the omission of the clause.

If the clause is omitted based on a determination under clause (2) a written report shall be furnished to the Congress. The power of the agency head to make the determination specified in the preceding sentences shall not be delegable.

STATEMENT

1. In 1973 and 1974, respondent Bristol Laboratories entered into three contracts with the Defense Supply Agency of the Department of Defense and one contract with the Veterans Administration for the sale of pharmaceutical products to the government. All four

were negotiated fixed-price contracts,[1] with a total price of approximately $2 million (App. B, *infra*, 6a–7a; C.A. App. 100–104).[2] As required by 10 U.S.C. 2313(b)[3] and 41 U.S.C. 254(c),[4] each of the contracts contained a standard access-to-records provision in which respondent agreed that "the Comptroller General of the United States or any of his duly authorized representatives shall, until the expiration of three years after final payment under this contract * * *, have access to and the right to examine any directly pertinent books, documents, papers, and records of the Contractor involving transactions related to this contract" (App. B, *infra*, 6a–7a; C.A. App. 101, 103).

Pursuant to these statutory and contractual provisions, the Comptroller General, by letter of August 26, 1974, made a timely request to Bristol for access to

> all books, documents, papers and other records directly pertinent to the contracts, which include, but are not limited to (1) records of experienced costs including costs of direct materials, direct labor, overhead, and other pertinent corporate costs, (2) support for prices charged to the Government, and (3) such other information as may be necessary for use to review the reasonableness of the contract prices and the adequacy of the protection afforded the Government's interests.

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[1] A negotiated government contract is a method of procurement authorized by statute to be used in situations in which the formal public advertising and bidding procedure is deemed impractical or unnecessary. See 10 U.S.C. 2304(a); 41 U.S.C. 252(c).

[2] "C.A. App." refers to the joint appendix filed by the parties in the court of appeals.

[3] See page 1, *supra*. This provision is applicable to the Defense Supply Agency contracts.

[4] See pages 1–2, *supra*. This provision is applicable to the Veterans Administration contract.

App. B, *infra*, 7a–8a; C.A. App. 71–72. In reply, respondent offered to make available "(1) Bristol's contract files which included shipment and invoice records, (2) records and data relating to manufacturing costs assigned by the firm to the products purchased under the contracts, and (3) Bristol's product prices to its non-Federal customers" (C.A. App. 81). However, respondent declined to produce "records concerning costs incurred for activities such as research and development, marketing and promotion, distribution and administration * * * [on the ground that] such costs are not assigned to individual products and records concerning these costs are not pertinent to the cited contracts" (*ibid.*). Respondent also refused to provide "records relating to the methodology and decisions involved in the firm's establishment of prices for the products purchased under the contracts" (*ibid.*). By letter dated March 6, 1975, the Comptroller General advised respondent that its proposal failed to satisfy the legal requirements under which the GAO request had been made (*id.* at 82).

2. On March 18, 1975, respondent commenced the present action in the United States District Court for the Southern District of New York seeking declaratory and injunctive relief against the Comptroller General (C.A. App. 24–28).[5] The United States later intervened as a defendant and filed a counterclaim to gain access to the records requested by the Comptroller General (C.A. App. 42–50).[6]

Respondent conceded in the district court that it was obligated "to provide access to records of its manufacturing costs, records which relate to the pricing of

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[5]Jurisdiction was asserted by respondent under 28 U.S.C. 1331, 1332, 1337, 2201–2202, and 5 U.S.C. 702 (C.A. App. 26).

[6]Jurisdiction over the counterclaim was based on 28 U.S.C. 1345 (C.A. App. 43).

the products delivered and records required to verify all data obtained during the course of the review" (App. A, *infra*, 8a). On this basis, it agreed to allow inspection of records pertaining to "the following items, which it lists as factors taken into account in setting prices to the government: manufacturing costs (including raw and packaging materials, labor and fringe benefits, quality control and supervision); manufacturing overhead (including plant administration, production planning, warehousing, utilities and security); royalty expenses; and delivery costs" (*ibid.*). However, respondent "strenuously resist[ed] producing data with respect to research and development, marketing and promotion, distribution and administration * * *" on the ground that these costs, which respondent neither allocated to particular products or contracts nor considered in setting the price charged to the government, "are too remote to the contracts and have only the most general relation, if any, to the prices charged" (*id.* at 8a–9a).

Following discovery, the district court granted respondent's motion for summary judgment and denied the cross-motion of the government (App. B, *infra*, 5a–12a).[7] The court rejected the government's argument that, with respect to respondent's unallocated costs, the access-to-records provisions authorized examination of "all costs met in whole or in part from revenues earned on the federal contracts * * *" (*id.* at 9a). Since respondent's unallocated costs "are pooled and met out of gross revenues * * * [consisting of] revenues from government contracts * * * co-mingled

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[7] The parties' initial motions for summary judgment were denied because of uncertainties concerning respondent's accounting methods (App. B, *infra*, 6a n.1; C.A. App. 18–23). These cross-motions were renewed after completion of the necessary discovery.

with revenues from non-government contracts," the court expressed its concern that the position urged by the government would mean that "there are no excludable records" and that respondent would be required "to make available virtually all of its books and records * * * because * * * government dollars * * * contribute to the fund from which all of the company's expenses are paid" (*id.* at 9a–10a). The court concluded that such a result would be "inconsistent" with the "words of limitation" in the access-to-records provisions authorizing the Comptroller General to examine "'directly pertinent * * * records * * * involving transactions related to [the] contract'" (*id.* at 10a; emphasis omitted); in the court's view, "[t]he reasonable assumption is that if Congress had wished to condition the receipt of a fixed-price negotiated contract on the contractors' agreement to allow such unusual and unfettered government inspection of their business records, it would have done so explicitly" (*ibid.*). In addition, the court held as a matter of contract law that "[t]he government's position is particularly unrealistic" because, in construing "the intent and understanding of the parties * * *, [i]t is inconceivable that [respondent], or any contracting firm, could have understood this clause to authorize the sweeping power of inspection claimed by the GAO" (*id.* at 10a–11a). Accordingly, the court sustained respondent's position as "a responsible and reasonable effort to distinguish 'directly pertinent' matter within the meaning of the access to records clause. It represents a sensible point at which to draw the line" (*id.* at 12a).

3. On the government's appeal, the court of appeals affirmed in a per curiam opinion for the reasons given by the district court (App. A, *infra*, 1a–4a).[8] The court

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[8] After both parties had initially appealed, the court of appeals remanded the case for consideration of respondent's request for

of appeals also noted that two intervening decisions of the Seventh Circuit had "reject[ed] the holding of the court below," but it did "not find their reasoning persuasive" (*id.* at 3a). See *Eli Lilly & Co.* v. *Staats*, 574 F.2d 904 (7th Cir.), cert. denied, 439 U.S. 959 (1978); *United States* v. *Abbott Laboratories*, 597 F.2d 672 (7th Cir. 1979).

REASONS FOR GRANTING THE PETITION

1. As the court of appeals recognized (App. A, *infra*, 3a–4a), its decision in this case conflicts with the decisions of the Seventh Circuit in *Eli Lilly & Co.* v. *Staats*, 574 F.2d 904, cert. denied, 439 U.S. 959 (1978), and *United States* v. *Abbott Laboratories*, 597 F.2d 672 (1979). All of these cases arose out of identical demands by the Comptroller General, under identical access-to-records provisions, for cost data pertaining to pharmaceutical products supplied to the government pursuant to negotiated fixed-price contracts. The Seventh Circuit in *Eli Lilly* expressly declined to follow the decision of the district court in the instant case (574 F.2d at 913) and ordered the contractor to make available the type of cost records denied to the Comptroller General here. By the same token, the Second Circuit, in affirming the district court in this case, explicitly rejected the *Eli Lilly* holding.[9]

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a protective order. Upon the consent of the parties, the district court approved a protective order on September 6, 1979 (App. A, *infra*, 3a n.2; C.A. App. 184–187). Thereafter, only the government pursued its appeal. No issue is presented in this petition concerning the need for or scope of an appropriate protective order.

[9]The decision below also conflicts in principle with *Hewlett-Packard Co.* v. *United States*, 385 F.2d 1013 (9th Cir. 1967), cert. denied, 390 U.S. 988 (1968). In that case, GAO "requested all books, documents, papers or records 'relating to the pricing

Resolution of the conflict by this Court is warranted. The Second and Seventh Circuits have disagreed on the proper construction of access-to-records provisions that, by statute, are applicable to virtually all of the government's negotiated procurement contracts throughout the country.[10] However, the ability of the Comptroller General to fulfill his assigned duties ought not depend on the location of the contractor or the venue of a lawsuit. In the present situation, forum shopping is encouraged, since contractors have an incentive to file suit in the Second Circuit whenever possible. What is more, the existing conflict is likely to hinder contractors' voluntary cooperation with GAO and to lead to further litigation in other circuits. For these reasons, the Court should review the decision of the court of appeals in this case.[11]

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and cost of performance, support for prices charged to the Government, and such other necessary information which would permit * * * [GAO] to review the reasonableness of the contract prices * * * ' " (385 F.2d at 1015). The district court granted the government's motion for summary judgment "and entered a judgment substantially as prayed for in the complaint" (385 F.2d at 1013–1014) declaring that GAO "could examine any such records 'relating to the cost of producing the items furnished by Hewlett-Packard Company under the aforesaid contracts, including costs of direct material, direct labor and overhead costs * * * ' " (385 F.2d at 1016). The court of appeals affirmed, holding that these costs "directly pertain to * * * [the contract], because if out of line with the contract price, the contract may have been an inappropriate means of meeting this particular procurement need of the Government" (*ibid.*).

[10] In fiscal year 1979, the total value of negotiated government contracts was approximately $78 billion. See Office of the Secretary of Defense, *Military Prime Contract Awards for Fiscal Year 1979*, Table 9; General Services Administration, *Procurement by Civilian Executive Agencies for Fiscal Year 1979*, Part I.

[11] The issue presented in this petition is currently pending in two other circuits. In *SmithKline Corp.* v. *Staats*, 483 F. Supp.

2. The court of appeals has misconstrued the access-to-records provisions and unduly restricted the Comptroller General's authority to promote sound government procurement practices. By failing to consider the purpose and legislative history of the provisions and to defer to GAO's interpretation that has been recognized by Congress, the court of appeals erred.

The inspection provisions in 10 U.S.C. 2313(b) and 41 U.S.C. 254(c) were enacted in 1951 as amendments to the Armed Services Procurement Act of 1947 and the Federal Property and Administrative Services Act of 1949. See Pub.L. No. 82-245, ch. 652, 65 Stat. 700. The Committee Reports expressed Congress' determination that "negotiated contracts * * * require close supervision and control * * *." H.R. Rep. No. 82-791, 82d Cong., 1st Sess. 2 (1951); S. Rep. No. 82-603, 82d Cong., 1st Sess. 2 (1951). Congressman Hardy, the sponsor of the legislation, explained that examination of contractors' records by the Comptroller General would enable "the Government Accounting Office to look behind the * * * [price] which had been established * * * [to assess whether it was] excessive" and would act as a "safeguard against waste and extravagance" in government procurement. 97 Cong. Rec. 13198 (1951). See also *id.* at 13373 (remarks of Rep. Hoffman) ("GAO is * * *the most effective agency we have against fraud and extravagance and waste and all those things"). As Congressman Hardy emphasized:

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712 (E.D. Pa. 1980), appeal pending, No. 80-1464 (3d Cir. filed Mar. 19, 1980), the court, although aware of the district court's decision in this case (*id.* at 719), "agree[d] with *Eli Lilly's* reasoning" (*id.* at 722). On the other hand, in *Merck & Co.* v. *Staats*, Civil Action No. 74-1447 (D.D.C. Aug. 12, 1977), appeal pending, Nos. 79-1435, 79-1438 (D.C. Cir. argued Feb. 11, 1980), which was decided prior to the court of appeals' decision in *Eli Lilly*, the court found "persuasive" and was "guided" by the district court's decision in the present case (slip op. 4-5).

> The major purposes of this bill are twofold: One, to give the Comptroller General the proper tools to do the job the Congress has instructed him to do; and, two, to provide a deterrent to improprieties and wastefulness in the negotiation of contracts.

Id. at 13198; see also *id.* at 13200 (remarks of Rep. Hardy). Congress "clearly understood * * * that there are a lot of other situations besides those involving fraud which might be uncovered" (*id.* at 13199) (remarks of Rep. Hardy). Because of its concern that "there is every chance in the world that the Government will come out on the short end of the deal," Congress enacted the access-to-records statutes to "enable the * * * [Comptroller General] to check the transaction, both from the Government records and the contractors' books" (*id.* at 13198) (remarks of Rep. Hardy).[12]

Prior to the decision in this case, the courts of appeals had broadly construed the access-to-records provisions to effectuate this congressional intent. As the court explained in *Hewlett-Packard*, *supra*, the Comptroller General is empowered to investigate whether a contractor's costs are "out of line with the contract price" and hence whether "the contract may have been

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[12] Congressman Hardy's bill did not originally contain the provision that records be "directly" pertinent. The word "directly" was added as a floor amendment offered by Congressman Hoffman, who explained that "[t]he purpose is to limit the 'snooping' that may be carried on under this bill * * *." 97 Cong. Rec. 13377 (1951). Congressman Hardy did not object to this modification, which passed without debate or discussion. In these circumstances, we do not believe that Congressman Hoffman's amendment significantly altered the scope or intendment of Congressman Hardy's bill or bars the Comptroller General's access to records legitimately needed to protect the government against waste, excessive prices, and ineffective procurement. See *Eli Lilly*, *supra*, 574 F.2d at 916 & n.8

an inappropriate means of meeting this particular procurement need of the Government" (385 F.2d at 1016). Similarly, in *Eli Lilly, supra,* the court of appeals followed "the broad reading of *Hewlett-Packard* * * * [as] most consistent with the plain meaning of the statutory language and with the legislative history" (574 F.2d at 913), and concluded that Congress envisioned "an inquiry [by the Comptroller General] into whether costs are excessive" (*id.* at 915). In departing from this understanding, the Second Circuit's decision frustrates the statutory objective and defeats the intention of Congress.

It is not a valid objection that the Comptroller General has sought access to records of costs that respondent does not allocate to individual products.[13] The government cannot be bound by the accounting method respondent has established for its own purposes. Cf. *Exxon Corp.* v. *Department of Revenue of Wisconsin,* No. 79-509 (June 10, 1980), slip op. 12-14. Moreover, respondent's election to keep its business records on the basis of unallocated costs cannot obscure the fact that an analysis of these costs is necessary for the Comptroller General to determine whether the price charged the government is fair and reasonable. To operate profitably, respondent must recover its costs from sales revenues, and it uses the payments by the government under the contracts at issue here, as part of commingled general revenues, to help to defray its unallocated expenses (C.A. App. 164, 166-169).[14] As the court of appeals explained in

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[13] It does appear, however, that respondent, by setting its prices in part on the basis of its historical pricing and that of its competitors, takes into account its unallocated costs (C.A. App. 137, 158, 164-166).

[14] The government was charged respondent's normal wholesale price (C.A. App. 158).

Eli Lilly, supra, the "inclusion [of unallocated costs] in the price of the product [purchased by the government] is not unforeseeable once the costs are incurred. * * * The mere fact that, as [respondent] asserts, it does not or even could not allocate costs such as research and development to an individual contract does not undercut the proposition that those costs are directly pertinent to an individual contract but merely indicates that they are directly pertinent to more than one individual contract" (574 F.2d at 914). Especially where, as in the pharmaceutical industry, "manufacturing and distribution costs of individual * * * products have been estimated to constitute as little as 9 per cent of the products' sale prices" (*id.* at 913) and manufacturers expend approximately 12 percent of sales revenues on research and development (C.A. App. 107), it is manifest that the Comptroller General's inquiry into the appropriateness of the contract price cannot be limited to allocated costs of production and delivery and must include such significant unallocated costs as research and development, marketing and promotion, distribution, and administration.[15]

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[15] Of course, insofar as respondent has allocated a given category of costs, the Comptroller General would be entitled to examine only such costs that have been attributed to the product supplied the government (together with records necessary to verify such data). To the extent that broader access is required, it is the result of respondent's decision not to allocate its costs and the consequent need for the Comptroller General to construct a measure of those costs in order to determine the reasonableness of the contract price. Whatever the nature of a contractor's accounting system, the Comptroller General's authority remains the same—to examine those costs necessary to determine whether the contract price was "extravagan[t]," "excessive," or "wasteful[ ]" (97 Cong. Rec. 13198 (1951) (remarks of Rep. Hardy)).

Moreover, GAO has consistently construed the access-to-records provisions to authorize examination of all cost records necessary to determine the reasonableness of the price charged the government, and Congress, although aware of this construction, has not indicated its disapproval of the agency's interpretation or amended the statutes to reject that position. See C.A. App. 108. In 1963, Robert Keller, General Counsel of GAO, explained GAO's "position that the contract clause and the statute give us the right to examine the cost records of the contractor and other pertinent data that relates to the items included in the contract, in sufficient completeness and detail to permit us to determine the reasonableness of the negotiated prices." *Hearings on Relation of Cost Data to Military Procurement Before the Subcomm. for Special Investigations of the House Comm. on Armed Services*, 88th Cong., 1st Sess. 10 (1963). Mr. Keller also noted that GAO's "interpretation of the statute has been consistently applied since its enactment without objection by the Congress * * * " (*id.* at 10–11). Congressman Hardy, based on his "background of personal knowledge * * * [of] what congressional intent was at the time * * * [the statutes were] originally passed" (*id.* at 3), commented that Mr. Keller had "stated this case very well as to the necessity for having a contract provision permitting audits of negotiated contracts" (*id.* at 23).

Two years later, GAO again apprised Congress of its construction of the access-to-records provisions. Comptroller General Campbell testified that these provisions "permit detailed examination of a contractor's records to insure the necessary degree of supervision and control. In other words, the clear intent of the statute is to provide for the examination by the General Accounting Office of such records of a contractor, to such an extent as will permit a meaningful

examination of the reasonableness of the prices charged to the Government." *Hearings on Comptroller General Reports to Congress on Audits of Defense Contracts Before the Subcomm. on Military Operations of the House Comm. on Government Operations*, 89th Cong., 1st Sess. 44 (1965). Mr. Campbell later reiterated GAO's position "that the contract clause and the statute on which the clause is based gives us the right to examine the cost records of the contractor and other pertinent data that relate to the items included in the contract, in sufficient completeness and detail to permit us to examine into the reasonableness of the negotiated prices" (*id.* at 45).[16] And General Counsel Keller also stated the agency's view "that the Congress intended the General Accounting Office to examine the books and records of the contractor to make certain that the Government was getting a fair deal out of negotiated contracts" (*id.* at 147).

In 1971, Congress was again advised of GAO's interpretation of the access-to-records provisions. Paul Shnitzer, Assistant General Counsel of GAO, testified that such access "is very good for the purpose of determining what costs the contractor actually incurred in the performance of the contract as compared to the contract price." *Hearings on Competitive Problems in the Drug Industry Before the Subcomm. on Monopoly of the Senate Select Comm. on Small Business*, 92d

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[16] Comptroller General Campbell's statement was clearly understood by Mr. Charles I. Derr, Senior Vice President, Machinery & Allied Products Institute, who described GAO's position to be "that the statute should be construed as broadly as is necessary in order to permit [GAO] to determine whether contract prices are reasonable" (*Hearings on Comptroller General Reports, supra*, at 513).

Cong., 1st Sess. 8018 (1971). Mr. Shnitzer then elaborated (*id.* at 8018-8019):

> What I am saying is, and we do have a case which ultimately went up as far as the Supreme Court, is that under our 1951 authority, the contract is required to include a provision which gives the GAO the right to examine records of costs, direct and indirect, generated in the performance of that contract. So if a contract is awarded to company A and it comes within the purview of this—it is a negotiated contract for, let us assume, $100,000—we would have a right then to go back and examine the records of company A—the cost records, direct and indirect, to determine how much it cost him to perform that contract * * *.

In light of this history, the court of appeals was plainly unwarranted in rejecting GAO's longstanding interpretation of the access-to-records provisions. See *Eli Lilly*, *supra*, 574 F.2d at 915. The court failed to heed the " 'venerable principle that the construction of a statute by those charged with its execution should be followed unless there are compelling indications that it is wrong * * *.' " *E.I. DuPont DeNemours & Co.* v. *Collins*, 432 U.S. 46, 54-55 (1977), quoting *Red Lion Broadcasting Co.* v. *FCC*, 395 U.S. 367, 381 (1969). And this principle is especially apt " 'when Congress has refused to alter the administrative construction' * * * [and] that construction accords with well-established congressional goals." *Board of Governors of the Federal Reserve System* v. *First Lincolnwood Corp.*, 439 U.S. 234, 248, 251 (1978), quoting *Red Lion Broadcasting Co.* v. *FCC*, *supra*, 395 U.S. at 381. Furthermore, the district court's conclusion that respondent's position appeared "reasonable" and "sensible" (App. B, *infra*, 12a) was insufficient to overcome the deference due GAO's interpretation. " 'To sustain * * * [GAO's] application of this statutory term, we

need not find that its construction is the only reasonable one, or even that it is the result we would have reached had the question arisen in the first instance in judicial proceedings.'" *Udall* v. *Tallman*, 380 U.S. 1, 16 (1965), quoting *Unemployment Comm'n* v. *Aragon*, 329 U.S. 143, 153 (1946). Rather, "[i]t is settled that courts should give great weight to any reasonable construction of a regulatory statute adopted by the agency charged with the enforcement of that statute." *Investment Company Institute* v. *Camp*, 401 U.S. 617, 626–627 (1971).

Finally, the court of appeals incorrectly relied on the presumed intentions of the parties to hold that the contractual access-to-records clause does not encompass the materials sought by the Comptroller General concerning respondent's unallocated costs. In view of the decision in *Hewlett-Packard* and GAO's public statements of its position to Congress, respondent was on notice of GAO's interpretation and cannot be assumed to have had a contrary understanding. See *Eli Lilly*, *supra*, 574 F.2d at 918. But, more importantly, the meaning of the contractual access-to-records clause does not rest on the understanding of the parties. The clause was statutorily required to be included in the contract, and its content is necessarily determined by those statutes rather than by the parties' intentions. See *e.g.*, *Federal Crop Insurance Corp.* v. *Merrill*, 332 U.S. 380, 383–385 (1947); *Dematteo Const. Co.* v. *United States*, 600 F.2d 1384, 1391 (Ct. Cl. 1979); *Jackson* v. *United States*, 573 F.2d 1189, 1194 (Ct. Cl. 1978).

CONCLUSION

The petition for a writ of certiorari should be granted.

Respectfully submitted.

WADE H. MCCREE, JR.
Solicitor General

ALICE DANIEL
Assistant Attorney General

MARK I. LEVY
Assistant to the Solicitor General

MICHAEL KIMMEL
ROBERT KAPLAN
Attorneys

AUGUST 1980

APPENDIX A

UNITED STATES COURT OF APPEALS
For the Second Circuit

SEPTEMBER TERM 1979

No. 679

ARGUED MARCH 10, 1980
DECIDED MARCH 25, 1980

Docket Nos. 77-6153

BRISTOL LABORATORIES DIVISION OF
BRISTOL-MYERS COMPANY, PLAINTIFF-APPELLEE,

against

ELMER B. STAATS, COMPTROLLER GENERAL
OF THE UNITED STATES,
DEFENDANT-APPELLANT,

-and-

UNITED STATES OF AMERICA,
INTERVENOR-DEFENDANT-APPELLANT.

Before: FRIENDLY and FEINBERG, Circuit Judges and SIFTON, District Judge.[1]

Appeal from judgment of the United States District Court for the Southern District of New York, Morris

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[1] Honorable Charles P. Sifton of the United States District Court for the Eastern District of New York, sitting by designation.

E. Lasker, J., denying appellant United States' cross-motion for summary judgment and granting appellee's motion for summary judgment in an action for declaratory and injunctive relief limiting appellant Comptroller's access to appellee's business records.

Affirmed.

MICHAEL H. DOLINGER, Assistant United States Attorney, New York, NY (Robert B. Fiske, Jr., United States Attorney for the Southern District of New York, New York, NY, Naomi Reice Buchwald, Assistant United States Attorney, Harland F. Leathers, Attorney, Department of Justice, John G. Brosnan, Attorney, General Accounting Office, of Counsel), for Appellants Comptroller General of the United States and United States of America.

ROBERT L. SHERMAN, New York, NY (Weil, Guttman & Davis, New York, NY, Gilbert H. Weil, of Counsel), for Plaintiff-Appellee.

PER CURIAM:

The United States and Elmer B. Staats, Comptroller General of the United States, appeal from a judgment of the United States District Court for the Southern District of New York, Morris E. Lasker, J., granting the motion of Bristol Laboratories Division of Bristol-Meyers Company ("Bristol") for summary judgment and denying the government's cross-motion for summary judgment. During 1973 and 1974, Bristol entered into negotiated fixed-price contracts with the Veterans Administration and with the Defense Supply Agency of the Defense Department; pursuant to 41 U.S.C. § 254(c) and 10 U.S.C. § 2313(b), these contracts contained a clause that granted the Comptroller "access to and the right to examine any directly pertinent" business records "involving transactions related

to" the contracts. In 1974, the Comptroller formally requested Bristol to make available all records "directly pertinent" to the contracts. The parties disagreed, however, as to what records were required to be produced; accordingly, Bristol commenced an action for declaratory and injunctive relief in order to limit the Comptroller's access to its records. Judge Lasker held that the government's interpretation of the access-to-records clause incorporated in the contracts was untenable as a matter of both statutory interpretation and contractual construction. This appeal followed.[2] We affirm for the reasons given in Judge Lasker's excellent opinion, reported at 428 F. Supp. 1388 (S.D.N.Y. 1977), to which we refer the reader.

We would see no reason to say anything further except that in the unusually lengthy period between Judge Lasker's opinion and this appeal, see note 2, supra, there have been two opinions in the United States Court of Appeals for the Seventh Circuit, upon which the government relies heavily, bearing on the scope of the Comptroller's authority to examine records similar to those he seeks here. See United States v. Abbott Laboratories, 597 F.2d 672 (7th Cir. 1979); Eli Lilly & Co. v. Staats, 574 F.2d 904 (7th Cir.), cert. denied, 439 U.S. 959 (1978). These cases reject the holding of the court below, but we do not find their reasoning persuasive. We note particularly that not only was there a vigorous dissent in *Lilly*, see 574 F.2d at 918 (Pell, J., dissenting), but also that the precedential force of that decision has been weakened by

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[2] Both parties filed timely notices of appeal from Judge Lasker's order. Subsequently, a panel of this court remanded the case for consideration of Bristol's request for a protective order without prejudice to prosecution of the appeals. In September 1979, the district court approved a protective order, which had been agreed to by the parties. Only the appeal of the government is before us today.

the reluctant concurrences of two members of the *Abbott* panel, see 597 F.2d at 674 (Pell, J., concurring), 675 (Wood, J., concurring). Compare also SmithKline Corp. v. Staats, No. 75-499 (E.D. Pa. Jan. 24, 1980) with Merck & Co., Inc. v. Staats, No. 74-1447 (D.D.C. filed Aug. 12, 1977), appeal docketed, No. 79-1435 (D.C. Cir. Apr. 30, 1979); see generally Case Comment, The Comptroller General's Authority to Examine the Private Business Records of Government Contractors, 92 Harv. L. Rev. 1148 (1979).

The judgment of the district court is affirmed.

APPENDIX B

UNITED STATES DISTRICT COURT
Southern District of New York

75 Civ. 1334

MEMORANDUM 45769

BRISTOL LABORATORIES DIVISION OF
BRISTOL-MYERS COMPANY, PLAINTIFF,

against

ELMER B. STAATS, COMPTROLLER GENERAL
OF THE UNITED STATES, DEFENDANT,

and

UNITED STATES OF AMERICA,
INTERVENOR-DEFENDANT.

APPEARANCES:

WEIL, GUTTMAN & DAVIS, ESQS.
60 East 42nd Street
New York, New York 10017
Attorneys for Plaintiff
Of Counsel: GILBERT H. WEIL, ESQ.
ROBERT L. SHERMAN, ESQ.

ROBERT B. FISKE, JR., ESQ.
United States Attorney for the Southern District of New York
One St. Andrews Plaza
New York, New York 10007
Attorney for Defendant and Intervenor-Defendant
Of Counsel: NAOMI REICE BUCHWALD, ESQ.
Assistant United States Attorney

J. ROGER EDGAR, ESQ.
Department of Justice

JOHN G. BROSNAN, ESQ.
General Accounting Office

LASKER, D.J.

This case arises out of a dispute between Bristol Laboratories Division of Bristol-Myers Company (Bristol) and Elmer B. Staats, Comptroller General of the United States, regarding the scope of Staats' contractual right to inspect Bristol's books and records. Bristol and the United States, as intervenor-defendant, seek a declaration of their respective rights and a corresponding injunction. The parties have renewed cross-motions for summary judgment.[1] Since no disputed issues of fact remain, the case is ripe for determination.

In 1973 and 1974 Bristol was awarded three negotiated fixed-price contracts for the sale of prescription drugs to the Defense Supply Agency. Pursuant to the provisions of 10 U.S.C. § 2313(b)[2] all three contracts contain a so-called access to records clause, which in pertinent part provides:

> "[Bristol] agrees that the Comptroller General of the United States or any of his duly authorized representatives shall, until the expiration of three years after final payment under this contract . . . have access to and the right to examine any di-

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[1] By Memorandum dated December 14, 1975 the original cross-motions were denied without prejudice because of insufficient data and the appearance of a material dispute regarding Bristol's accounting methods. The necessary discovery is now complete, and the facts have been clarified.

[2] 10 U.S.C. 2313(b) provides:

> "(b) Except as provided in subsection (c), each contract negotiated under this chapter shall provide that the Comptroller General and his representatives are entitled, until the expiration of three years after final payment, to examine any books, documents, papers, or records of the contractor, or any of his subcontractors, that directly pertain to, and involve transactions relating to, the contract or sub-contract."

> rectly pertinent books, documents, papers, and records of [Bristol] involving transactions related to this contract."

In 1973 Bristol obtained a similar contract with the Veterans Administration which, pursuant to 41 U.S.C. § 254(c),[3] contains an identical access to records clause. Final payment on all of these contracts was complete by the end of July, 1974.

By letter dated August 26, 1974 Staats formally requested Bristol to make available to him cost records relating to the four contracts. He explained that the request was one of several directed at companies which supply pharmaceuticals to federal government agencies as part of a general review of drug procurement being undertaken by the General Accounting Office (GAO). He alluded to recent attempts by the GAO to conduct a comprehensive study of pricing practices in the pharmaceutical industry and the refusal of the drug manufacturers voluntarily to supply the information requested. Staats specified that he wished to inspect certain records including

> " . . . but not limited to (1) records of experienced costs including costs of direct materials, direct labor, overhead, and other pertinent corporate costs, (2) support for prices charged to the Gov-

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[3] 41 U.S.C. 254(c) provides:

> "(c) All contracts negotiated without advertising pursuant to authority contained in this chapter, chapter 11C of Title 5, chapter 10 of Title 40, and chapter 11 of Title 44 shall include a clause to the effect that the Comptroller General of the United States or any of his duly authorized representatives shall until the expiration of three years after final payment have access to and the right to examine any directly pertinent books, documents, papers, and records of the contractor or any of his subcontractors engaged in the performance of and involving transactions related to such contracts or sub-contracts."

ernment, and (3) such other information as may be necessary for use to review the reasonableness of the contract prices and the adequacy of the protection afforded the Government's interests." (Staats Letter, August 26, 1974; Exhibit A, Weil Affidavit).

Bristol responded that it was agreeable to providing records "deemed pertinent" to the contracts. (Purdy Letter, September 13, 1974; Exhibit B, Weil Affidavit) In the ensuing months, however, after further correspondence and meetings between GAO and Bristol personnel, it became apparent that there were irreconcilable differences regarding the proper scope of the GAO review. The differences focus on the GAO's right to examine records pertaining to the costs of research and development, marketing and promotion, distribution and administration.

Bristol agrees that it is obliged by the terms of the contracts to provide access to records of its manufacturing costs, records which relate to the pricing of the products delivered and records required to verify all data obtained during the course of the review. Accordingly, Bristol states that it is ready and willing to allow GAO personnel to inspect its books and records with regard to the following items, which it lists as factors taken into account in setting prices to the government: manufacturing costs (including raw and packaging materials, labor and fringe benefits, quality control and supervision); manufacturing overhead (including plant administration, production planning, warehousing, utilities and security); royalty expenses; and delivery costs. However, it strenuously resists producing data with respect to research and development, marketing and promotion, distribution and administration (except to the extent that these areas may be included in the factors listed above), because it claims that these costs are too remote to the contracts

and have only the most general relation, if any, to the prices charged.

The United States insists that the GAO may inspect Bristol's records with respect to any and all costs met in whole or in part from revenues earned on the federal contracts, whether or not those costs are specifically assigned by Bristol to the contracts or the products delivered. According to the government the test is simply "whether the burden of [the] costs is borne by the Government in the prices it must pay for the contract items." (Government's Memorandum, August 29, 1975 at 13)

The Government's theory has far reaching implications. The only items excludable from the Comptroller General's reach would be those, if any, which relate to the costs recovered exclusively from non-government contracts. (Government's Memorandum, August 29, 1975 at 13) It is undisputed, however, that Bristol does not separately compute the cost of government and non-government contracts or pay for them out of separate funds. Accordingly, there are no excludable records under the Government's theory. Indeed, the company does not compute the costs attributable to any particular contract. It does allocate certain direct costs, for manufacturing and overhead, by product. Records of these expenses are thus readily available and are among those the company concedes to be discoverable. Its other expenses are not allocated at all; they are pooled and met out of gross revenues. In other words, revenues from government contracts are co-mingled with revenues from non-government contracts, and the resulting fund is used to pay for all expenses. If the government's interpretation of the access to records clause is correct, Bristol will be required to make available virtually all of its books and records, because although it is impossible to trace the use of government dollars, those dollars contribute to

the fund from which all of the company's expenses are paid.

Such a result would be inconsistent with the language of the access to records clause and the statutes pursuant to which the clause was included in the contracts. The clause provides that GAO representatives may examine "*directly pertinent* books, documents, papers and records . . . *involving transactions related to* [the] contract." (Emphasis supplied) This language is taken almost verbatim from the statutes which require the clause in all fixed-price negotiated contracts. 10 U.S.C. § 2313(b) requires that all such contracts with Defense agencies must provide that the GAO may examine all records "that *directly pertain to*, and *involve transactions relating to*, the contract." (Emphasis supplied) Similarly, 41 U.S.C. § 254(c), which controls the contract with the Veterans Administration, requires that provision be made for inspection of "any *directly pertinent* books . . . of the contractor . . . *involving transactions related* to such contracts." (Emphasis supplied) All of the underscored phrases are words of limitation. It is a distortion of the language to argue that it permits GAO officials to discover virtually everything there is to know about the structure of the contractors' business. The reasonable assumption is that if Congress had wished to condition the receipt of a fixed-price negotiated contract on the contractors' agreement to allow such unusual and unfettered government inspection of their business records, it would have done so explicitly.

There is an additional important reason for rejecting the government's interpretation. Although the access to records clause has its origins in statute, it is nevertheless a contractual provision. We are thus confronted with the task of construing the contracts, a task which turns on the intent and understanding of the parties regarding the import of the access to rec-

ords clause at the time the contracts were entered. The government's position is particularly unrealistic when viewed in this light. It is inconceivable that Bristol, or any contracting firm, could have understood this clause to authorize the sweeping power of inspection claimed by the GAO. As a matter of contractual construction, the government's argument falls of its own weight.

The government's contention that Bristol is obligated to open all of its books and records for perusal was implicitly rejected by the court in *Hewlett-Packard v. United States*, 385 F.2d 1013 (9th Cir.), *cert. denied*, 390 U.S. 988 (1967), the single reported decision construing the access to records clause. The court's discussion clearly reflects its conclusion that an order granting the Comptroller General access to a contractor's books "without limitation" would contravene the limiting language in the statutes and the clause itself. 385 F.2d 1015–16.[4] In *Hewlett-Packard* the court simply ordered the contractor to make available records relating to its production costs, over the contractor's argument that this information is not "directly pertinent" to the contract because production

[4] Nor can the government draw support from the unreported decision in *Eli Lilly and Company* v. *Staats*, No. IP75-72—(S.D. Ind. Nov. 30, 1976), a case which, like the instant controversy, also grew out of Staats' attempt, in August, 1974, to use the access to records clause to obtain detailed information relating to the structure of the pharmaceutical industry. Lilly was evidently willing to disclose far less information than Bristol and presented a number of facts and legal arguments which Bristol has not put forth. The court granted Lilly's motion for summary judgment, ruling that Staats' request exceeded his authority, was of doubtful constitutionality and far exceeded the scope of the access to records clause. It permitted Staats to examine only those files and records relating specifically to the government contracts and only to the extent necessary to determine the relation between the standard catalogue price of the products and the prices charged to the government.

costs were not taken into account in arriving at the terms and conditions of the contracts in question. Since production costs are among the items Bristol has agreed to provide, the decision in *Hewlett-Packard* is of no positive aid in resolving the instant controversy.

Having rejected the government's position, it remains to determine the appropriate scope of the Comptroller General's examination. He is, of course, entitled to examine all "directly pertinent records involving transactions related to the contract." Although these words give general guidance, they do not provide answers to the specific questions which arise in the context of each case. We agree with the government that the issue should not depend entirely on a contractor's bookkeeping method, i.e., whether it does or does not assign particular costs to particular contracts or products. However, we do not understand this to be Bristol's contention. As set forth above, Bristol allocates only the direct costs of manufacture by product. These are among the costs it offers to make available, but they are by no means the limit of its offer. Rather, Bristol is willing to provide all records relating to manufacturing costs and the pricing of the products sold to the government. The specific list of items Bristol offers to make available, set forth at page 3, *supra*, appears to reflect a responsible and reasonable effort to distinguish "directly pertinent" matter within the meaning of the access to records clause. It represents a sensible point at which to draw the line.

For the foregoing reasons, Bristol's motion for summary judgment is granted, and the government's motion is denied.

Submit judgment on notice.

Dated: New York, New York
April 7, 1977.

/s/MORRIS E. LASKER
U.S.D.J.

APPENDIX C

UNITED STATES COURT OF APPEALS
For the Second Circuit

77-6153

At a stated Term of the United States Court of Appeals for the Second Circuit, held at the United States Courthouse in the City of New York, on the twenty-fifth day of March one thousand nine hundred and eighty.

Present: Hon. HENRY J. FRIENDLY
Circuit Judge

Hon. WILFRED FEINBERG
Circuit Judge

Hon. CARLES P. SIFTON
District Judge

BRISTOL LABORATORIES DIVISION OF BRISTOL-MYERS COMPANY, PLAINTIFF-APPELLEE

v.

ELMER B. STAATS, COMPTROLLER GENERAL OF THE UNITED STATES, DEFENDANT-APPELLANT,

UNITED STATES OF AMERICA, INTERVENOR-DEFENDANT-APPELLANT.

Appeal from the United States District Court for the Southern District of New York.

This cause came on to be heard on the transcript of record from the United States District Court for the

Southern District of New York, and was argued by counsel.

ON CONSIDERATION WHEREOF, it is now hereby ordered, adjudged, and decreed that the judgment of said District Court be and it hereby is affirmed in accordance with the opinion of this court with costs to be taxed against appellants.

A. DANIEL FUSARO,
Clerk

/s/ _____
by: EDWARD J. GUARDARO
Deputy Clerk

(A true copy)

/s/ROLANNE HENRY
Deputy Clerk

APPENDIX D

UNITED STATES DISTRICT COURT
Southern District of New York

Civil Action No.
75 CIV 1334 (MEL)
JUDGMENT

BRISTOL LABORATORIES DIVISION OF
BRISTOL-MYERS COMPANY, PLAINTIFF,

-against-

ELMER B. STAATS, COMPTROLLER GENERAL
OF THE UNITED STATES, DEFENDANT,

and

UNITED STATES OF AMERICA,
INTERVENOR-DEFENDANT.

The plaintiff, Bristol Laboratories Division of Bristol-Myers Company, having duly moved for an order directing the entry of summary judgment in its favor and against the defendant, Elmer B. Staats, Comptroller General of the United States, and the intervenor-defendant, United States of America, and the intervenor defendant, United States of America, having cross-moved for an order directing the entry of summary judgment in its favor, and said motions having regularly been submitted to this Court on the 15th day of November, 1976, and this Court having rendered a memorandum decision dated April 7, 1977 granting plaintiff's motion for summary judgment and denying intervenor-defendant's motion, and directing that judgment be submitted on notice, it is therefore

ORDERED, ADJUDGED AND DECREED

(1) That the motion for summary judgment of the intervenor-defendant, United States of America, be, and the same hereby is denied.

(2) That the motion for summary judgment of the plaintiff, Bristol Laboratories Division of Bristol-Myers Company, be, and the same hereby is granted in all respects.

(3) That the Comptroller General and all persons representing him or acting under his direction and authority or acting in concert or participation with him, have no right to make any efforts or take any steps to gain access to or to examine any of plaintiff's books, documents, papers or records, or to seek access to or examine any of plaintiff's books, documents, papers or records, except for 1) those containing manufacturing costs (including raw and packaging materials, labor and fringe benefits, quality control and supervision); manufacturing overhead (including plant administration, production planning, warehousing, utilities and security); royalty expenses and delivery costs of the products delivered pursuant to government contracts identified as DSA 120-73-D-1769, V797P-5929b, DSA 120-74-C-2404 and DSA 120-74-C-2724, whether or not those costs are assigned by plaintiff to any of the said contracts or products; 2) those relating to the pricing of the products delivered pursuant to said government contracts, whether or not those costs are assigned by plaintiff to any of the said contracts or products; and 3) those required to verify the data obtained in the course of the review.

(4) That the Comptroller General and his representatives shall not have access to or the right to examine any books, documents, papers, and records of Bristol relating to expenses incurred for research and development, advertising and promotion; general and

administrative and distribution except as those expenses come within the scope of the preceding paragraph.

(5) That the Comptroller General or a duly authorized representative or representatives of him may have access to those of plaintiff's books, documents, papers or records permitted by paragraph (3) herein, at the premises of plaintiff, Syracuse, New York, at a time that is mutually convenient to plaintiff and the Comptroller General, on prior notice to plaintiff of at least two weeks.

(6) That the counterclaim of intervenor-defendant, United States of America, be, and the same hereby is, dismissed.

Dated: New York, New York
July 13, 1977.

s/ MORRIS E. LASKER

U.S.D.J.

JUDGMENT ENTERED 7/15/77

/s/RAYMOND F. BURGHARDT
Clerk

A True Copy

RAYMOND M. BURGHARDT,
Clerk

BY WM MULLIGAN
Deputy Clerk

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